

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND
PERFORMANCE INFORMATION OF TOKOLOGO MUNICIPALITY FOR THE YEAR ENDED
30 JUNE 2008**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Tokologo Local Municipality which comprise the statement of financial position as at 30 June 2008, and the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting as set out in accounting policy note 1 and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal controls as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Retained surplus

4. Retained surplus is disclosed at R7 299 864 (2007: R8 351 031) on the face of the balance sheet. I was unable to confirm whether balances disclosed as comparative figures and incorporated in the opening balances of retained earnings were adjusted to correct and attend to misstatements and limitations that caused me, not to express an opinion on the financial statements for the year ending 30 June 2007.
5. The retained earnings as at 30 June 2008, disclosed in note 16 to the financial statements amounting to R15 489 972 does not agree to the R7 299 864 surplus disclosed on the face of the balance sheet. The difference amounting to R8 190 108 could not be substantiated by documentary evidence.
6. The opening balance of the retained earnings per the general ledger exceeded the 2007 balance of retained earnings by R3 108 713. The noted difference could not be explained or substantiated. I was furthermore unable to gather sufficient appropriate evidence to

confirm the correct treatment and suitability of journal entries increasing retained earnings by R9 457 576 and journals decreasing retained earnings by R4 942 062. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, the impact of these matters could not be assessed.

7. As reported in paragraph 28 below, the retained earnings disclosed on the face of the balance sheet as at 30 June 2008 is overstated by R445 283 due to electricity expenditure recorded in the incorrect period.

Fixed assets

8. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness, valuation of and rights to fixed assets with a gross carrying value of R76 555 341 (2007: R76 040 561) presented in the balance sheet and disclosed in note 6 to the financial statements.
9. The gross carrying value of fixed assets disclosed at R76 555 341 in note 6 to the financial statements does not agree to the fixed asset register which reflects a gross carrying value of R110 106 487. In the absence of reconciliations for the differences noted, I was unable to quantify assets not included in the annual financial statements and consequently I could not confirm by alternate means that all fixed assets that should have been included in the financial statements, have been included. It could also not be confirmed that assets were included at appropriate amounts and that the municipality has the unrestricted rights of ownership, control and use of assets disclosed in the financial statements.
10. The corresponding amount for fixed assets, disclosed at R76 040 561 in the balance sheet and note 6 to the financial statements does not agree to fixed assets disclosed in the audited financial statements for the year ending 30 June 2007 amounting to R76 555 340. Neither of these amounts agree to the opening balance of the fixed asset register for the year ending 30 June 2008 which amounted to R82 338 695. In the absence of reconciliations or explanations for differences noted, I was unable confirm by alternative means that the accounting records supported the values disclosed as fixed assets in the financial statements.
11. Clinics amounting to R485 260 were reflected in the fixed assets register. These clinics were transferred to provincial government. In the absence of adequate information on the disposed assets being maintained by the municipality, I was unable to confirm that all disposed items were correctly removed from the fixed asset register. The valuation and existence of these assets could not be confirmed through alternative procedures while other account balances affected could not be identified.
12. Property, plant and equipment amounting to R65 914 224 could not be physically verified due to inadequate descriptions in the fixed asset register. Physical assets verified and municipal property owned could furthermore not be identified in the fixed assets register. Due to limitations placed on the scope of my work, I could not gather sufficient appropriate evidence to confirm that all fixed assets existed and that fixed assets were accurately accounted for.
13. Adequate documentation in support of additions to property, plant and equipment amounting to R25 546 270 could not be obtained.

14. Sufficient appropriate evidence to substantiate journals increasing fixed assets for the year ending 30 June 2008 by R684 010 could not be obtained.
15. Additions amounting to R3 066 292 were recorded in the fixed asset register inclusive of value added tax (VAT). The value of fixed assets would have decreased by R376 563 and debtors would have increased by the same amount, had additions been recorded appropriately.

Unspent conditional grants

16. Schedules that supported grant expenditure and grant revenue could not be obtained. Grant receipts and expenditure were not processed in separate bank accounts and detailed disclosure of grant receipts required by section 123 of the MFMA was not included in the financial statements. With municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to confirm grant expenditure incurred, the correctness of revenue amounting to R11 080 118 or valuation of unspent grants amounting to R1 750 406 included under creditors in the annual financial statements.

Revenue

17. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the completeness, occurrence, accuracy and correct cut-off of revenue R23 469 320 (2007: R33 542 879) presented on the face of the income statement for the year ending 30 June 2008.
18. Revenue for 2007 disclosed at R33 542 879 in corresponding amounts included in the financial statements could not be agreed to revenue amounting to R35 652 376 disclosed in the audited financial statements for the year ending 30 June 2007. In the absence of alternative procedures the occurrence and accuracy of revenue disclosed could not be confirmed.
19. With reference to paragraph 16 above, the accuracy, completeness, occurrence and correct cut-off of grant revenue amounting to R11 080 118 could not be confirmed.
20. Sufficient appropriate evidence to substantiate journals increasing revenue for the year ending 30 June 2008 by R12 133 283 could not be obtained. Conversely, journals decreasing revenue by R1 440 437 could not be obtained. In the absence of available alternative audit procedures the accuracy and occurrence of these transactions could not be confirmed.
21. A recalculation of water charges using actual water meter readings indicated that water revenue would have increased by a projected R361 818 had water revenue been charged accurately. Similarly electricity revenue would have increased by a projected R644 289, sewerage revenue would have increased by a projected R41 610 and refuse revenue would have increased by R34 617 had services been charged accurately.
22. Legislated government grants and subsidy receipts amounting to R17 844 000 could not be agreed to supporting schedules or general ledger accounts that amounted to R10 923 169. A difference of R6 920 831 was identified. Due to the circumstances already described in paragraph 16 above, I could not obtain sufficient appropriate audit evidence

to quantify misstatements and identify balances and transaction totals impacted by government grant receipts not processed or processed incorrectly.

23. The completeness, occurrence and accuracy of revenue from water services amounting to R3 419 307 that is included under revenue disclosed in the income statement could not be confirmed due to various inconsistencies and limitations identified. The recalculated total consumption noted negative meter readings which decreased from month to month. While debtors that were not billed for water services were identified, information and documentation relating to the accounting and recognition of indigent subsidies as well as information on distribution losses could not be obtained.
24. Direct income registers, certain deposit books, detailed schedules, reconciliation of fines, evidence on rental from camps, supporting documentation to sundry income and consumer billing details for the month of October 2007 could not be obtained. In the absence of the abovementioned documentation and schedules I was unable to confirm by alternative means whether all revenue was included in the financial statements and whether identified revenue amounting to R2 469 253 actually took place.
25. Property rates included under revenue disclosed in the income statement for the year ended 30 June 2008 amounted to R 1 373 050. These rates were levied based on a general valuation performed in 1996. In the absence of supplementary or interim valuations being performed no other alternative audit procedures were available to confirm the completeness of rates revenue.
26. As reported in paragraph 77 interest earned would have increased by R1 449 293 had investments been disclosed at amounts confirmed by financial institutions.
27. Interest earned amounting to R303 367 was inappropriately allocated to revenue. This was also reported in paragraph 70 below.

Expenditure

28. Electricity expenses relating to the year ending 30 June 2007 was inappropriately recognised as expenditure during the year ending 30 June 2008. Expenditure in the income statement is therefore overstated with R445 283 and retained earnings in the balance sheet are understated with the same amount.
29. Expenditure amounting to R5 636 904 was inappropriately accounted for inclusive of value added tax (VAT). Had VAT been appropriately accounted for expenditure would have decreased and debtors would have increased by R695 804.
30. Instances were identified where the actual payments made to suppliers were less than the expenditure recorded in the accounting records. In the absence of reconciliations or explanations for the differences noted the occurrence of expenses amounting to R430 854 included in the income statement could not be confirmed.
31. As reported in paragraph 90 diesel inventory that was written off subsequent to 30 June 2008 should have been written off prior to year end. Expenditure is therefore understated by R870 750 and accumulated surplus opening balance is understated with the same amount.
32. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to determine whether journal entries that increased expenditure included on the

face of the balance sheet by R2 369 059 were correct or recorded at the correct amounts. Conversely, journal entries that decreased expenditure by R5 222 068 could not be confirmed.

33. Due to the limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to substantiate expenditure amounting to R8 404 941 that was included under expenditure in the income statement. The limitations experienced furthermore prohibited the identification of fruitless and wasteful expenditure and confirmation of any intentional circumvention of requirements of the supply chain policies.
34. As reported in paragraph 41 accounts with debit balances amounting to R2 432 005 were included under creditors. The recoverability of these balances could not be determined and the possible misstatement in debtors, expenditure and creditors could not be quantified.
35. As reported in paragraph 54 below interest not charged that related to electricity, water, sewerage and refuse resulted in an understatement of revenue amounting to R1 235 849.

Salaries and Wages

36. In the absence of documentation in support of journals and municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to substantiate journal entries increasing salary costs by R12 286 324 and journal entries decreasing salaries by R1 506 925. In the absence of alternative audit procedures the accuracy, occurrence and correct cut-off of salary costs amounting to R12 892 043 that was included under expenditure in the income statement for the year ending 30 June 2008 could not be confirmed.
37. Suspense accounts relating to employee costs totaling R1 662 934 were not cleared at year end. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I was not able to determine whether any adjustments might have been necessary to the amounts shown in the financial statements for employee cost and debtors.
38. As reported in paragraph 45 the impact that misstatements in leave accruals amounting to R400 203 had on salaries and wages could not be quantified due the inadequacy of leave documentation available.

Creditors

39. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness, valuation of and obligations related to creditors disclosed at R12 008 883 (2007: R7 665 664) on the face of the balance sheet and in note 11 to the financial statements.
40. Creditors amounting to R2 432 005 included in note 11 to the financial statements did not show any movement during the financial year nor any payments subsequent to 30 June 2008. Creditors balances furthermore included unreconciled suspense accounts amounting to R1 817 982 while documentation in support of creditors' account balances amounting to R9 577 034 could not be obtained. The existence, valuation, obligations to

and completeness of the municipality's creditors could not be confirmed from alternative audit procedures.

41. Accounts with debit balances amounting to R2 049 853 were included under creditors. The recoverability of these balances could not be determined and the possible misstatement in debtors, expenditure and creditors could not be quantified.
42. The corresponding figure for creditors is disclosed as R7 665 664 on the face of balance sheet and in note 11 to the annual financial statements. The opening balance of creditors per the general ledger is R9 028 293. Explanations and reconciliations of the difference of R1 362 629 could not be obtained. In the absence of available alternative audit procedures the valuation, completeness, existence and obligation of creditors disclosed at R12 008 883 on the face of the balance sheet and in note 11 to the financial statements could not be confirmed.
43. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I could not gather sufficient appropriate evidence to confirm the valuation and completeness of journal entries that increased creditor accounts by R13 924 922 and journal entries that decreased creditor accounts by R559 409.
44. Unrecorded accruals amounting to R882 764 were identified. Due to limitations placed on the scope of my work, I could not confirm the completeness of creditors disclosed. In addition, it was not possible to determine whether creditors are valued correctly.
45. Creditors included leave accruals amounting to R400 203. The completeness and valuation of the calculated leave accrual could not be confirmed due the inadequacy of leave documentation. Therefore the impact of misstatements on creditors and employee costs could therefore not be assessed.
46. Creditors was overstated by R3 996 676 due to VAT being inappropriately incorporated under both debtors and creditors. This was reported in paragraph 60 below.

Provisions

47. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness, valuation of and obligations related to provisions disclosed at R7 299 864 (2007: R8 351 031) on the face of the balance sheet.
48. I was unable to confirm whether provisions amounting to R8 351 031 disclosed as comparative figures and incorporated in account opening balances were adjusted to correct and attend to misstatements and limitations that caused me, not to express an opinion on the financial statements for the year ending 30 June 2007.
49. The opening provisions per the general ledger exceeded the provisions disclosed as corresponding amounts on the face of the balance sheet, note 10 to the annual financial statements and amounts disclosed in the audited financial statements for the year ending 30 June 2007 by R11 072 648. In the absence of alternative procedures the completeness, valuation and allocation, existence and obligation relating to provisions could not be confirmed.
50. Detailed calculations, information and schedules supporting provisions disclosed at R54 838 551 on the face of the balance sheet and note 10 to the annual financial

statements could not be obtained. I could furthermore not obtain sufficient appropriate evidence to substantiate journals increasing provisions as at 30 June 2008 by R81 652 501. Conversely, sufficient appropriate evidence to substantiate journals decreasing provisions as at 30 June 2008 by R16 000 172 could not be obtained. I could, consequently, not confirm the valuation and existence of all provisions as disclosed in the financial statements.

Debtors

51. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness, valuation of and rights to debtors. Debtors before provision for bad debts are disclosed at R31 622 938 (2007: R19 420 246) in note 8 to the financial statements.
52. Consumer debtors that were included in debtors before provision for bad debts amounting to R21 766 431 according to the debtor's age analysis, could not be agreed to the R24 546 795 disclosed for these debtors in the general ledger accounts. The difference of R2 780 364 could furthermore not be reconciled or explained by management. In the absence of available alternative audit procedures I could not confirm that debtors are complete. I was unable to confirm that amounts were due for services rendered or that the municipality had a right to the amounts due.
53. Debtors with general ledger opening balances totaling R10 138 113 could not be agreed or reconciled to the balance of R15 339 743 included in the prior year audited annual financial statements and corresponding amounts to debtors reflected in the financial statements. Similarly, the general ledger opening balances for provision for bad debts amounting to R15 339 743 could not be agreed or reconciled to the balance of R4 080 503 disclosed as the corresponding amount in note 8 to the financial statements.
54. Interest charged to debtors was based on outstanding balances relating to rates and taxes and did not take electricity, water, sewerage and refuse balances into account. Interest charges and debtors would have increased by R1 235 849 had interest been charged on all outstanding balances. The policy on interest was however only approved in June 2008 and by-laws that related to interest charges were not passed.
55. Based on receipt history and amounts recovered from debtors during the year ended 30 June 2008 the provision for bad debts disclosed at R12 151 182 in note 8 to the annual financial statements were assessed to be overly conservative. A reliable provision could not be determined as a result of the limitation of scope of debtors and revenue.
56. Receipts subsequent to year end as well as schedules and documentation substantiating debtors amounting to R2 645 976 could not be obtained. Municipal records did not permit the application of adequate alternative audit procedures regarding debtor balances. Consequently, I did not obtain sufficient appropriate audit evidence regarding the recoverability of these amounts that form part of debtors balance disclosed on the face of the balance sheet and note 8 to the financial statements.
57. As reported in paragraph 14 above, debtors would have increased by R376 563 had VAT on fixed assets additions been allocated appropriately. Similarly debtors would have increased by R1 082 334 had all revenue reported in paragraph 20. Debtors were understated by the value added tax (VAT) on expenditure amounting to R692 251 that was inappropriately accounted for inclusive of VAT. This was also reported in paragraph 29 above.

58. As reported in paragraph 37 suspense accounts relating to employee costs totaling R1 662 934 that were not cleared at year end. As municipal records did not permit the application of alternative audit procedures it prohibited the quantification of any adjustments that might have been necessary to debtors disclosed on the face of the balance sheet and note 8 to the financial statements.
59. As reported in paragraph 41 accounts with debit balances amounting to R2 049 853 were included under creditors. The recoverability of these balances could not be determined and the possible misstatement in debtors, expenditure and creditors could not be quantified.

VAT receivable

60. VAT was inappropriately incorporated under both debtors and creditors in the balance sheet as at 30 June 2008. Debtors and creditors would have decreased by R3 996 676 had VAT been appropriately accounted for.
61. VAT receivable was included in debtors reflected at R19 471 756 on the face of the balance sheet and note 8 to the financial statements. Journals that decreased the VAT receivable included debtors by R1 254 341 could not be validated to supporting documentation.
62. VAT due to the municipality as at 30 June 2008, according to a confirmation received from the South African Revenue Services, and VAT calculated, on debtors as per municipal accounting records totaled R3 702 624. This amount could not be agreed to the consolidated R1 251 580 VAT receivable per the accounting records of the municipality. Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I was unable to quantify the impact on VAT included under debtors, creditors, expenditure and revenue.

Cash and cash equivalents

63. Cash is disclosed at R51 681 516 (2007: R210 236) on the face of the balance sheet. I was unable to confirm whether balances disclosed as corresponding figures and incorporated in the opening balances of cash and cash resources were adjusted to correct and attend to misstatements and limitations that caused me, not to express an opinion on the financial statements for the year ending 30 June 2007.
64. The opening cash and cash equivalents per the general ledger exceeded the 2007 cash and cash equivalent balances by R20 463 793. Cash resources in the general ledger furthermore exceeded the cashbook balance reflected in the bank reconciliation for the month ending 30 June 2008 by R2 388 401. The differences noted was neither reconciled nor explained.
65. Direct deposits amounting to R9 469 219 were reflected as reconciling items in the bank reconciliation for the month ending 30 June 2008. If direct deposits had been recognised in the accounting system, the bank account in the general ledger would have increased by R9 469 219. The impact on unrecorded deposits on revenue and debtors could not be quantified.
66. I could not gather sufficient appropriate audit evidence to substantiate journals increasing cash and cash equivalents for the year ending 30 June 2008 of R86 760 548.

67. Outstanding cheques amounting to R2 503 932 still reflected in the bank reconciliation were not cashed within 6 months subsequent to the reporting date. Cash and cash equivalents would have increased by R2 503 932 had these cheques been written back timeously.

Accumulated funds, Housing Trading Account and Reserves

68. Accumulated funds amounting to R6 443 415 (2007: R5 919 576), reserves amounting to R337 152 (2007: R337 152) and the housing trading account amounting to R558 395 (2007: R558 394) is disclosed on the face of the balance sheet and in note 1, 2 and 3 respectively. I was unable to confirm whether balances disclosed as corresponding figures and incorporated in account opening balances were adjusted to correct and attend to misstatements and limitations that caused me not to express an opinion on the financial statements for the year ending 30 June 2007.
69. Due to the limitation of scope described in the paragraphs below, I was unable to carry out all the audit procedures I considered necessary for my audit on accumulated funds disclosed at R6 443 415 (2007: R5 919 576), the housing trading account disclosed at R558 395 (2007: R558 394) and reserves amounting to R337 152 (2007: R337 152).
70. Interest earned amounting to R303 367 was inappropriately allocated to revenue. The correct allocation of the interest earned would have increased accumulated funds to R6 747 782.
71. I could not gather sufficient appropriate evidence to substantiate journals increasing statutory funds for the year ending 30 June 2008 by R524 044.
72. The financial statements do not contain the required accounting policies for each material fund and reserve as indicated in the standards laid down by the Institute of Municipal Treasurers and accountants in its Code of Practice, 1992, (IMFO). The absence of disclosed or adopted accounting policies prohibited the assessment of the contributions, interest allocation, expenditure allowed and the general purpose of funds and reserves disclosed.
73. The housing trading account and reserves disclosed, respectively, at R558 395 and R337 152 on the face of the balance sheet and in note 2 and 3 to the annual financial statements showed no movement since 1 July 2004. Documentation in support of the balances disclosed could not be provided by the municipality. In the absence of available alternative audit procedures the completeness, valuation and allocation, rights and obligations with regards to the housing trading account and reserves and the existence of housing trading account and reserves could not be confirmed.

Capital commitments

74. No capital commitments were disclosed in the annual financial statements. A contract register, project schedule or other alternative documentation to evaluate commitments that should have been reflected in the financial statements could not be obtained. In the

absence of alternative audit procedures, I could not gather sufficient appropriate evidence to quantify commitments that should have been disclosed.

75. Lease payments amounting to R241 023 were identified in the accounting records of the municipality. Contracts relating to lease payments could not be obtained. Contract registers and reference numbers relating to lease payments made could not be obtained. The limitation of scope prohibited the assessment of the appropriate allocation of lease payments and the quantification of possible lease commitments not disclosed. In the absence of alternative audit procedures the impact on lease disclosures, the retained earnings, fixed assets, expenditure, current and non-current liabilities could not be quantified.

Going concern

76. The municipality is largely dependant on financial support received from government. In the absence of grants and subsidies the municipality will not generate sufficient internal revenue to fund their total expenditure. The material uncertainty on future funding sources may cast significant doubt on the municipality's ability to continue as a going concern and was not disclosed in the annual financial statements.

Investments

77. Investments were disclosed at R8 737 406 (2007: R8 707 406) on the face of the statement of financial position and note 7 to the annual financial statements. Interest earned on external investments is not disclosed in the financial statements. Investments would have amounted to R 58 339 876 and interest earned would have amounted to R1 449 292 had investments been disclosed at amounts confirmed by financial institutions.
78. Investments disclosed at R8 737 406 on the face of the balance sheet and in note 7 to the annual financial statements were readily convertible into known amounts of cash and should have been classified as cash and cash equivalents in terms of the standards laid down by the Institute of Municipal Treasurers and accountants in its Code of Practice, 1992, (IMFO).

Consumer deposits

79. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness, valuation of and rights to consumer deposits that are disclosed at R258 048 (2007: R248 356) on the face of the balance sheet and in note 5 to the annual financial statements.
80. I was unable to confirm whether balances disclosed as comparative figures and incorporated in consumer deposit opening balances were adjusted to correct and attend to misstatements and limitations that caused me not to express an opinion on the financial statements for the year ending 30 June 2007.

81. No consumer deposit register or sub-ledger was furthermore kept by the municipality. In the absence of available alternative procedures it could not be confirmed that all consumer deposits that should have been recorded.

Unauthorised expenditure

82. Unauthorised expenditure amounting to R481 751 identified in the prior year was not disclosed in the annual financial statements as required by section 125(2)(d) of the MFMA. Evidence could not be obtained that unauthorised expenditure was treated in accordance with section 32 of the Municipal Finance Management Act, Act 56 of 2003.
83. Instances where actual expenditure per vote exceeded the budgeted expenditure amounted to R12 699 059. This amount was in contravention of section 125 of the MFMA, not disclosed as unauthorised expenditure in the financial statements for the year ended 30 June 2008.

Inventory

84. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness, valuation of and rights to inventory disclosed at R1 880 029 (2007: R872 510) on the face of the balance sheet and note 9 to the financial statements.
85. Inventory disclosed represented diesel stock amounting to R870 750 and game amounting to R1 007 529. No inventory count took place at year end and no other documentation in support of inventory values as at 30 June 2008 could be obtained. Supporting documentation could not be obtained for an inventory sub-account amounting to R662 610. This sub account was allocated to fixed assets in the financial statements. In the absence of available alternative audit procedures the completeness, valuation and allocation, rights to inventory and the existence of inventory could not be confirmed.
86. I could not gather sufficient appropriate audit evidence to substantiate journals increasing inventory for the year ending 30 June 2008 by R1 009 150. In the absence of available alternative audit procedures the completeness, valuation and allocation, rights to inventory and the existence of inventory represented by these transactions could not be confirmed.
87. As reported in paragraph 90 diesel stock was written off subsequent to year end. In the absence of evidence supporting the existence of diesel stock and documentary evidence supporting the value of game stock as at 30 June 2008, alternative audit procedures to confirm that all inventory existed, that all inventory were recorded in the accounting records and that inventory were recorded at appropriate values could not be obtained.

Contingent liability

88. A contingent liability amounting to R1 129 710 that related to litigation against the municipality was not disclosed in the notes to the financial statements for the year ending 30 June 2008.

Events after the reporting date

89. The confirmation of the contingent liability referred to in paragraph 88 above was not disclosed as an event after the reporting date. Confirmation was received on 5 February 2009 that the liability exists and the matter should therefore have been disclosed as event after the reporting date in the notes to the annual financial statements.
90. Diesel inventory amounting to R870 750 was written off subsequent to 30 June 2008. No evidence of the existence of this inventory as at 30 June 2008 could be obtained. Based on available information this event represents an adjustable event subsequent to the reporting date which should have been accounted for in the financial statements for the year ending 30 June 2008. Inventory would have decreased and expenditure would have increased by the mentioned amount had the inventory been appropriately accounted for.

Long term liabilities

91. Long term liabilities disclosed on the face of the balance sheet, represents the value of fixed assets which had a credit balance at year end. As reported in paragraphs 8 to 15 above, transaction totals and balances that were impacted by misstatements included under fixed assets, could not be identified and quantified.

Irregular expenditure

92. Certain members of management were in contravention of section 57(1) (a) of the Municipal Systems Act, Act No 32 of 2000 employed and remunerated without written contracts being in place for periods that ranged between 3 and 13 months. Based on municipal records the irregular expenditure not disclosed in this regard amounted to R345 499.
93. Expenditure incurred that were not approved by the authorised official as required by section 79 (1) of the MFMA was identified. The R2 968 320 irregular expenditure was however not disclosed in the financial statements.
94. Expenditure excluding employee related cost and capital contributions included in the income statement amounted to R17 226 166. Despite the supply chain management policy being approved in May 2008 evidence to demonstrate implementation and compliance to the policy could not be obtained. A procurement unit was furthermore not established to manage bid evaluation and adjudication. Due to the limitations experienced and in the absence of documentation to demonstrate tender and quotation processes followed, I could not gather sufficient appropriate evidence that expenditure excluding employee related cost and capital contributions were incurred in terms of an approved Supply Chain Management policy. Consequently I could not obtain adequate audit evidence regarding the completeness of irregular expenditure.

Fruitless and wasteful expenditure

95. Fruitless and wasteful expenditure that related to the late payment of VAT amounting to R46 599, VAT paid on invoices with invalid VAT numbers amounting to R32 900 and payments in excess of supporting documents amounting to R5 033 was identified. These amounts were not treated as prescribed by the Municipal Finance Management Act, was not classified as fruitless and wasteful expenditure and details were not disclosed in the annual financial statements as required by section 125(2)(d) of the MFMA.

96. As reported in paragraph 33, the limitation to the scope of the audit experienced relating to documentation supporting expenditure amounting to R8 404 941 prohibited the identification of fruitless and wasteful expenditure and the confirmation of any intentional circumventions of the requirements of the supply chain policies.

Other disclosure

97. The notes to the financial statements do not include the total amounts paid in audit fees, taxes, levies, duties and pension and medical aid contributions, and whether any amounts were outstanding as at the end of the financial year. The financial statements furthermore do not disclose particulars of non-compliance with the MFMA as required by section 125.

Disclaimer of opinion

98. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the following matter on which I do not express a disclaimer of opinion:

Basis of accounting

99. The municipality's policy is to prepare financial statements on the entity specific basis of accounting as set out in accounting policy note 1.1.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

100. The supplementary information as set out in appendix A to E on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Material inconsistencies in other information included in the annual report

101. Other information that will be included in the annual report could not be obtained and could not be reviewed to identify material inconsistencies in other information included in the annual report.

Non-compliance with applicable legislation

Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

102. The accounting officer did not submit, by no later than 10 working days after the end of each month, the statement to the mayor and provincial treasury related to the state of the municipality's budget as required by section 11 of the MFMA.
103. A municipal code of conduct was not adopted and communicated as required by section 62(1) (b) of MFMA.
104. It could not be confirmed that the Mayor submitted a time schedule, outlining key deadlines related to the budget process, as envisaged by section 21(b) of MFMA.
105. Documentary evidence could not be obtained that the annual budget was made public and that the local community was invited to make representations on the budget in line with section 22 (a) of MFMA.
106. Documentary evidence that the approved annual budget was submitted to the National Treasury and Provincial Treasury in terms of section 24(3) of the MFMA could not be obtained.
107. Evidence of consultations on tabled budgets as required by Section 23 of the MFMA could not be provided.
108. The municipality did not utilise a service delivery and budget implementation plan during the year ended 30 June 2008 as required by section 56 of MFMA.
109. Actual expenditure exceeding budgeted expenditure as reported in paragraph 82 and 83. No reports were however submitted to the council for excess expenditure as required by section 70(1) of the MFMA and an adjustment budget was not prepared and approved as required by section 72(3) of MFMA.
110. The annual budget did not detail cash flow per revenue source per month as required by section 17(3)(c) of the MFMA.
111. Tokologo Municipality did not disclose information with regards to the details of their bank accounts in the notes to the financial statements which is required in terms of section 125 (2)(a) of the MFMA.
112. The accounting officer did not table in the municipal council a consolidated report of all withdrawals (payments) made within 30 days after the end of each quarter. Evidence that the accounting officer submitted a copy of the report to the provincial department responsible for local government in the province and to the Auditor-General in terms of section 11(4) of MFMA were not obtained.
113. Reports required by section 52(d) of the MFMA regarding the implementation of the budget and the financial state of affairs of the municipality and expenditure reports for staff benefits required by section 66 of the MFMA were not submitted to council.
114. Despite non-compliance to the MFMA, no reports on non-compliance were submitted to Treasury. The accounting officer furthermore did not report any reasons for an inability to report on non-compliance as envisaged by section 74(1) of MFMA.

115. The accounting officer did not submit the monthly reports on the state of the municipality's budget to the mayor of the municipality and the relevant provincial treasury as required by section 11 of MFMA.
116. No evidence could be obtained that the mayor tabled the quarterly financial reports to the council as required by section 52 of MFMA.
117. The municipality did not have formally approved and documented systems of internal control, with regard to revenue, expenditure, employee cost, asset and stores management during the year under review, which is not in compliance with section 61(b) of MFMA.
118. The municipality did not have an action plan to address issues raised by the Auditor-General i in the management report of 2006/7 which is required in terms of section 131(1) of MFMA.
119. Evidence that reports in terms of section 32 (4) of the MFMA with regards to unauthorised, irregular, fruitless and wasteful expenditure were submitted to the relevant parties were not obtained.

Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

120. No performance agreements exist between the Municipality and the municipal manager or between the municipality and managers directly accountable to the municipal manager. This represents non compliance to section 57(1) (b) of the MSA.
121. A municipal code required by section 15 of the MSA (Ex.293) and an approved municipal structure required by section 66 of the MSA were not obtained.
122. The municipality did not comply with section 95 of the MSA in respect of levying of rates, other taxes and fees for municipal services.
123. The municipal council did not adopt by-laws to give effect to the implementation and enforcement of the tariff policy and credit control and debt collection policy as required by section 75 of the MSA.
124. Not all trade creditors were paid within 30 days of receipt of the relevant invoice as required by section 65(2)(e) of the MFMA.

Division of Revenue Act, 2008 (Act no 2 of 2008) (DoRA)

125. Compliance to section 11 of the DoRA could not be confirmed. Evidence of the certification to confirm that the municipality exclusively appropriated for programs funded by DoRA in its annual budget could not be obtained. No evidence could be obtained that the municipality made public the conditions and other information in respect of the allocation received to facilitate performance measurement. Evidence that the municipality reported to the National Treasury and transferring national officer on the spending and financial performance against programmes, the use of required inputs and outputs and reporting on non-financial performance could not be confirmed.
126. No evidence could be obtained that Tokologo Local Municipality evaluated the programmes funded by schedule 6 allocations within two months after year-end as required by section 16 of the DoRA.

Water Systems Act , 1997 (Act no. 108 of 1997)

127. Evidence that the Water Services plan and by-laws required by sections 12, 13 and 21(1) of the Water Services Act was drafted, approved and implemented by the municipality could not be obtained.

Governance framework

128. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4-7	Retained earnings	1				
8-15	Fixed assets	7		5		
16	Unspent conditional grants			4		
17-27	Revenue	5		5		
28-35	Operating expenditure			4		
36-38	Employee cost	2		6		
39-46	Creditors			4		
47-50	Provisions			4		
51-59	Debtors	6		5		
60-62	VAT receivable			3		
63-67	Cash and cash equivalents			4		1
68-73	Accumulated funds, Housing Trading Account and Reserves	1				
74-75	Capital commitments	1				
76	Going concern	1				
77-78	Investments			6		
79-81	Consumer deposits			3		
82-83	Unauthorised expenditure	1				
84-87	Inventory			4		
88	Contingent liabilities	1				
89-90	Events after reporting date	1				
91	Long term liabilities	1				

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
92-94	Irregular expenditure	1				
95-96	Fruitless and wasteful expenditure	1				
97	Disclosure and other matters	1				

Internal control deficiencies

129. Section 62(1) (c) (i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Overall reflections of the governance framework based on internal control deficiencies

130. The control environment was mostly affected by the inadequacy of control activities. The effectiveness and functioning of internal controls were adversely affected by the lack of approved written policies and procedures and the failure to create a strong control environment through specific allocation of responsibility with regards to each area where internal controls required improvement.
131. Limited management oversight, a lack of monitoring processes and inadequate supporting documentation for financial transactions contributed to an environment susceptible to undetected fraud and error.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial report	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4

The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self-assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

132. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		X
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.	X	
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		X
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines [section 126 of the MFMA].		X
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.	X	

No.	Matter	Y	N
Development and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	The Municipality had an audit committee in operation throughout the financial year.		X
	The audit committee operates in accordance with approved, written terms of reference.		X
	The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
7.	Internal audit		X
	The Municipality had an internal audit function in operation throughout the financial year.		X
	The internal audit function operates in terms of an approved internal audit plan.		X
	The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		X
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		X
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		X
10.	The information systems were appropriate to facilitate the preparation of the financial statements.	X	
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 95(c)(i) of the MFMA.		X
12.	Delegations of responsibility are in place, as set out in section 106 of the MFMA.		X
Follow-up audit findings			
13.	The prior year audit findings have been substantially addressed.		X
14.	SCOPA resolutions have been substantially implemented		X
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		X
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		X
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Local Municipality against its mandate, predetermined objectives, outputs, indicators and targets in terms of section 87 of the MFMA.		X
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		X

Overall reflections on the governance framework based on other key governance requirements

133. The audit was suspended after the planning phase of the audit in April 2009 due to imbalances identified by management in draft financial statements. The audit was resumed in October 2009 after receipt of annual financial statements. The significant time delay on submission of the financial statements, the organisational structure and the lack of implemented policies at Tokologo Municipality did not support proper recording and monitoring of accounting transactions. These weaknesses affected the availability of a proper audit trail and the ability of the financial section to provide documentation.
134. The municipality did not have an internal audit unit or audit committee during the year ended 30 June 2008 due to management not driving the necessary processes to facilitate appointments. An internal auditor was however appointed on 3 November 2008.
135. The municipality did not conduct a risk assessment during the year ended 30 June 2008 and a risk management strategy that includes a fraud prevention plan was not developed.
136. No formal delegations have as yet been effected by either the municipal council or the accounting officer. It was however noted that the municipality has compiled a draft set of delegations, but it could not be established whether it has been formally adopted by the municipal council.
137. The municipal manager was required to report several items as per Resolution No. 38/2005 to the Special Investigating Unit (SIU) for investigation. The Committee was not satisfied with the responses presented, as it was clear that the municipal manager did not report matters to the SIU.
138. No performance management system was defined and it is unclear whether systems will support performance information as the municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed.

Investigations

139. An investigation is being conducted on uncompleted Rural Development Programme housing projects. This investigation is being conducted by the Department of Local Government and Housing. The investigation was still ongoing at the reporting date.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

140. I was engaged to review the performance information.

The accounting officer's responsibility for the performance information

141. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

142. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and read in conjunction with section 45 of the MSA.
143. In terms of the foregoing, my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
144. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

145. Tokologo Municipality has not reported performance against predetermined objectives, as required by Section 121(3)(c) of the MFMA.
146. The entity furthermore did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

APPRECIATION

147. The assistance rendered by the staff of the Tokologo Local Municipality during the audit is sincerely appreciated.

Auditor-General
Bloemfontein

5 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence